



best value to our customers

annual report FY 2002

Defense Finance and Accounting Service Annual Report Fiscal Year 2002

Best Value to our Customers

The faces and fingerprints throughout this annual report represent the many DFAS customers who rely on the payments we deliver and the business intelligence we provide. These customers — more than 5.7 million of them — deserve the very best.

Nobody knows the business of defense finance and accounting better than DFAS. Throughout the year, DFAS professionals deliver on-time and on-target results that meet the individual needs of each and every customer.

Day in, day out, DFAS people support the men and women who defend America by:

- delivering pay and entitlements to those who put their lives in harm's way every day of every year
- paying the contractors who provide materiel and support for national security
- providing business intelligence to empower our nation's leaders who make decisions affecting national defense

These faces and fingerprints reflect the great diversity of our customers' missions and needs. DFAS exists to serve each and every one of them.



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A Message to DFAS Stakeholders

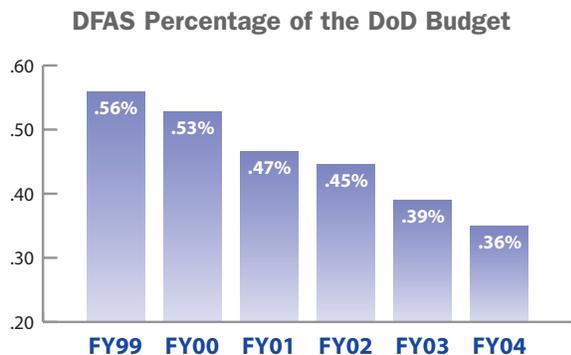
The people of the Defense Finance and Accounting Service take pride in serving the men and women who defend America. We take our contribution to national defense seriously. We work hard to fulfill the important fiscal responsibilities entrusted to us by the American taxpayers. We ensure the resources they provide are accounted for properly.

We are pleased to share our record of accomplishments and our plan of action to achieve the DFAS vision of becoming best value to our customers as:

- A world-class provider of finance and accounting services
- A trusted, innovative financial partner
- One organization, one identity
- An employer of choice, providing a progressive and professional work environment

Best Value to DFAS Customers

DFAS customers deserve the very best value for their mission dollar. Fiscal 2002 saw our DFAS team make significant strides on two fronts — enhancing the quality of DFAS products and services and lowering the cost for DFAS customers in the Department of Defense. Together, we improved the timeliness of accounting reports, decreased the number of overaged invoices in commercial pay, and enhanced the features and performance of myPay — DFAS' automated system that provides customers 24/7 access to their pay account information from anywhere in the world.



Operational efficiencies and organizational streamlining enabled DFAS to reduce costs to customers by more than \$144 million in FY 2002. We forecast an additional \$108 million reduction in customer charges in FY 2003. Since FY 1999, the cost of operating DFAS has progressively decreased in relation to the overall Defense Department budget and will continue to decline, illustrating DFAS' commitment to delivering best value to our customers.

A World-Class Provider

Growing challenges continue to stretch the defense dollar. We must provide our customers with world-class products and services. DFAS strives to ensure Defense Department leaders have the business intelligence to make the best decisions. DFAS employees work to ensure defense industry partners receive the timely payments they need to provide materiel and services. Most importantly, the DFAS team takes care to guarantee the men and women of the Armed Forces and Defense Department civilian employees have confidence in knowing their entitlements are delivered on time and on target. Our customers deserve the best and we will not be satisfied with providing them anything less.

In FY 2002 our customers received better value for their contractor support dollar. This year, DFAS recorded its lowest average percentage of overaged invoices on hand. By improving invoice processing, DFAS lowered the amount of interest our customers paid per million dollars they spent by over 30 percent compared to FY 2001.

For the third consecutive year, DFAS improved its accounting reporting timeliness, achieving a 99.96 percent on-time delivery rate. Meanwhile, DFAS accountants worked with the Defense Commissary Agency and Defense Contract Audit Agency to help them earn unqualified — or “clean” — opinions on their financial statements.

DFAS earned an unqualified opinion on our FY 2002 consolidated financial statements, marking our third consecutive unqualified opinion. This strengthens our credibility as we advise our customers on obtaining their own unqualified opinions.

For further information regarding our audited financial statements, please visit <http://www.dfas.mil>.

A Trusted, Innovative Partner

DFAS professionals continually look for ways to strengthen fiscal systems and services for our customers. Our client executives and their staffs work closely with leaders of the Army, Navy, Air Force, Marine Corps and Defense Agencies to provide business intelligence that enables customers to perform their missions with greater confidence.

In FY 2002, DFAS improved the way more than 5.7 million customers access and manage their pay records by rolling out myPay. Now that pay records are available anytime from anywhere, people paid by DFAS have the key to control their pay account information. Today, customers can do almost anything online that yesterday required them to stand in line. Visit <https://mypay.dfas.mil>.

One Organization, One Identity

The DFAS team is growing stronger, more cohesive and better integrated. Our strategic vision, our planning process and our use of the Balanced Scorecard give everyone a clear view of how we are doing and where we are headed. Flagship communication products and a state-of-the-art ePortal intranet allow us to share knowledge and information across every level and every location within DFAS. Our new corporate logo — shown on this report's cover — symbolizes who we are. The typeface conveys strength and forward motion. The star within the "D" recalls DFAS' military and defense heritage. The "check" spotlights a number of positive themes. First, it represents approval. Second, it connotes the successful completion of a significant task. Third, it symbolizes the core functions of DFAS from the checks and balances performed in accounting operations to the millions of electronic "checks" to our customers.

An Employer of Choice

It is the DFAS people who are the foundation for DFAS success. Our mission relies on trained professionals dedicated to excellence and service. Fielding the sharpest team requires quality retention, meaningful training and innovative recruiting.

To retain qualified professionals, DFAS provides a progressive and professional work environment,

career training and educational opportunities, competitive pay and benefits, a team atmosphere and a shared sense of mission.

DFAS is committed to providing the best growth and learning opportunities. In FY 2002, we invested \$30 million in work force training, about 4.3 percent of labor costs as compared to 2.7 percent for U.S. private companies and federal organizations studied by the American Society for Training and Development.

To build a future generation of finance and accounting professionals, we recruit only the best candidates in numerous career fields to enhance our depth and diversity. DFAS offers a rewarding choice for professionals answering the call to public service and taking on the challenge of working in the world's largest finance and accounting operation.

Moving Forward

Today's DFAS is just the beginning. Tomorrow's DFAS will offer greater capabilities and even better value to our customers. Transforming DFAS ensures our organization will continually meet its mission and surpass the expectations of our nation's leaders and the American taxpayers.

We are taking a critical look at each business process so that the DFAS team can proceed smartly and pursue opportunities to improve our enterprise. Our customers are the reason we exist. You deserve the very best. The DFAS team will not be satisfied with delivering anything less.

Only by anticipating tomorrow's challenges can DFAS continue to meet its commitment of providing the best value to customers and being Your Financial Partner @ Work.



Thomas R. Bloom
Director



Rear Adm. Mark A. Young
Deputy Director

“DFAS made great progress in FY 2002 by delivering higher quality products and service and reducing customers’ costs by more than \$144 million. Higher quality plus better affordability equals best value.”

–Susan J. Grant
Director, Corporate Resources
Defense Finance and Accounting Service



The State of DFAS

Cost to Customers (\$M)

	FY01	FY02	FY03*
Army	613	555	515
Navy	389	346	320
Marine Corps	83	78	75
Air Force	334	314	288
Agencies	264	246	233
Total	\$1,683	\$1,539	\$1,431

Operating Costs



Total Work Force



The world's largest finance and accounting operation

- Paid 5.7 million military members, civilian personnel, retirees and annuitants
- Processed 11.2 million contractor invoices
- Made 7.3 million travel payments
- Disbursed \$346.6 billion
- Recorded 124 million accounting transactions
- Accounted for 267 active DoD appropriations
- Managed \$176 billion in military retirement trust funds
- Accounted for \$12.5 billion in foreign military sales

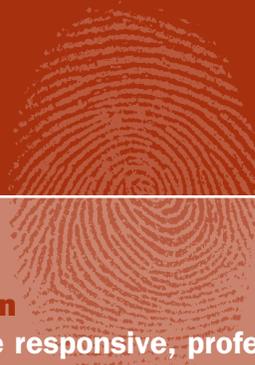
In 1991, the Secretary of Defense created the Defense Finance and Accounting Service to reduce the cost of Defense Department finance and accounting operations and to strengthen financial management through consolidation of finance and accounting activities across the department. Since inception, DFAS has consolidated more than 300 installation-level finance and accounting offices into 26, and reduced the work force from about 27,000 to approximately 16,000 personnel.

DFAS is financed by its customers rather than through direct appropriations. This service-provider relationship with its customers pushes DFAS to seek continuous innovation and improvement in the quality of services it provides. DFAS has steadily reduced its operating costs and has returned these savings to customers in the form of decreased bills.

DFAS is big business and is focused on organizing to provide bottom line best value to our customer.

Read more about DFAS at <http://www.dfas.mil>.

* Figures for all outyears are projected numbers.



Mission

Provide responsive, professional finance and accounting services for the people who defend America.

Vision

Best value to our customers:

- **A world-class provider of finance and accounting services**
- **A trusted, innovative financial partner**
- **One organization, one identity**
- **An employer of choice, providing a progressive and professional work environment**



DFAS Mission

Provide responsive, professional finance and accounting services for the people who defend America

“... for the people who defend America.” The DFAS mission focuses on the customer. Everything DFAS people do contributes to providing better service, more accurate information, and higher quality products to ensure our customers receive the best value.

Our mission reaches from the everyday activity for the individual customer to the far-reaching event that supports national security. It encompasses such things as processing the semimonthly pay for soldiers, sailors, airmen and Marines and helping the military retiree on a customer service call. It extends to providing information used to give Defense Department leaders visibility over the state of their fiscal affairs. It ensures invoices are paid on time so that private sector companies continue providing support and materiel for national defense. The bottom line is that DFAS satisfies the needs of each unique customer to help fulfill that customer's mission.

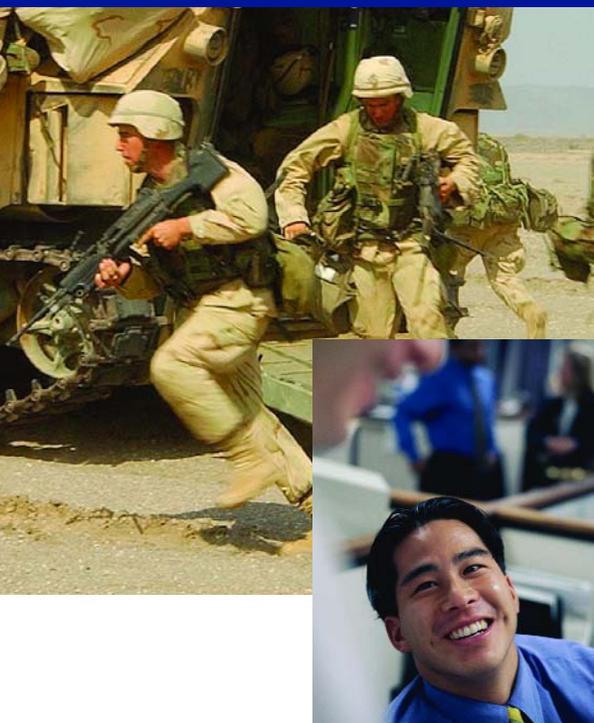
Nothing matters more to our professionals than serving the men and women of America's Armed Forces. This commitment to serve energizes DFAS people toward becoming a world-class finance and accounting organization and instills personal pride in delivering the best value to our customers. DFAS people are proud to have their fingerprints on everything we deliver to our customers.

“The 125th Finance Battalion has been in Bosnia since early March 2002. Before we left I wanted to personally comment on the outstanding support we received from certain DFAS soldiers and civilians . . .many good things came from this deployment as a result of some dedicated folks.”

– Lt. Col. Curt Rauhut (USA)
Commander, 125th Finance Battalion
Eagle Base - Tuzla



DFAS Operations



Operations organized for the customer

The DFAS enterprise is organized to align with customer needs. To ensure each major customer receives dedicated attention, DFAS assigns a client executive to each Military Service and the Defense Agencies to serve as the primary point of contact. Each client executive's main focus is to understand the specific needs of that customer and then to ensure each of our three business lines fulfills that customer's needs.

DFAS Organization



The DFAS business line executives deliver specific products and services:

- The Military and Civilian Pay Services Business Line Executive manages all aspects of pay to individuals — paychecks, travel reimbursements and garnishments.
- The Commercial Pay Services Business Line Executive provides payment services to all contractors doing business with the Department of Defense.
- The Accounting Services Business Line Executive provides departmental and field-level accounting and disbursing services.

The DFAS enterprise also includes a number of specialized corporate services that support internal personnel and operations to ensure sufficient resources and tools are available to meet organizational needs.

Located in 26 locations worldwide, DFAS has invested in a secure information technology infrastructure linking employees with each other and with DFAS customers. This robust infrastructure, augmented by e-government solutions, enables DFAS to provide services globally on a 24/7 basis that enhance support and value to DFAS customers.

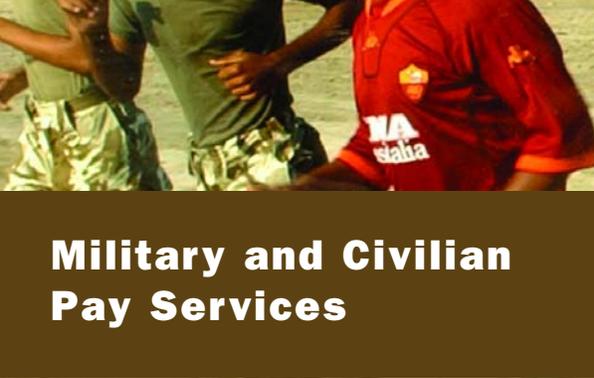
Cost of Operations (\$M)

	FY02	FY01	FY99
Salaries & Wages	879	869	892
Systems	389	385	408
Operations Support	161	157	160
Security, Facilities	81	70	68
Materials & Services	59	66	82
Total	\$1,569	\$1,547	\$1,610

“ From the onset, she was helpful. She patiently listened to what I had to say, and did not try to make my problem fit some kind of ‘cookie-mold’ solution. . . . You can not imagine what a relief that was, for I thought then that this was someone who cares about her work and the impact it has on people’s lives.”

–James S. Smith
DFAS Customer
commending Liz Carr of Military/Civilian Pay Services





Military and Civilian Pay Services



Treat customers like family and offer them a 100 percent warranty

On the receiving end of every payment is someone who has served our nation. These customers can take comfort in knowing the DFAS team will deliver their pay and entitlements accurately and on time.

The Military and Civilian Pay Services Business Line provides all forms of payments to individuals, almost entirely through electronic funds transfer.

DFAS pays 5.7 million people, including:

- Members of the Army, Navy, Air Force, Marine Corps
- Department of Defense civilians
- Executive Office of the President personnel
- Military retirees and annuitants

Military and Civilian Pay Services Business Line people also perform critical support functions that include:

- Staffing call centers and help desks to solve individual customer problems
- Defining and testing changes to automated pay systems
- Processing garnishment, debt and waiver applications
- Working with federal, state and local taxing authorities

In FY 2002, DFAS upgraded myPay (<https://mypay.dfas.mil>), a Web-based system that allows customers to manage their pay account information securely and easily from around the world, night or day. This innovative, customer-focused solution empowers customers to take charge of their pay account information and lets them avoid long lines by handling changes and inquiries online.

DFAS is fully committed to supporting the war against terror. Alongside deployed finance units, DFAS provides in-theater support to our deployed men and women. Support to mobilized service members includes payroll disbursements, check cashing, currency conversion and contracting.

For military and civilian pay customers, best value means respecting their time by making their pay information easier to manage, improving accessibility and resolving problems quickly to the customer's complete satisfaction. DFAS takes pride in working with deployed finance units to ensure fiscal integrity within theater and assisting commanders with their stewardship responsibilities. Moving forward, DFAS looks to strengthen its customer service and to continue providing timely and accurate pay support whenever and wherever it is needed.

Integrity Innovation Service

“One of the major reasons that DFAS has become so successful is their communication with the contractor. Through major industry associations such as the AIA, PSC and DIL, top management has taken the time to listen to our issues and to provide briefings so that we have a better understanding of their processes. It is amazing to think of how many process improvements DFAS has made.”

–Jan Wilhelm
Director, Business Operations
Northrop Grumman Corporation



Commercial Pay Services



Streamlining processes to reduce operating costs and improve service

The Commercial Pay Services Business Line pays all defense industry partners, ranging from small business vendors to large-scale weapons system developers.

Commercial Pay Services disbursed approximately \$213 billion in FY 2002 through two product lines - Contract Pay and Vendor Pay. Ninety-five percent of these payments were made electronically to DFAS customers.

In Contract Pay, approximately \$87 billion was paid to defense contractors primarily associated with major weapons system delivery and support.

Vendor Pay entails payment for day-to-day goods and services, such as supplies, utilities and transportation support. The total payments for these vendor products in FY 2002 reached nearly \$126 billion.

In FY 2002, DFAS made significant progress in improving management of systems and processes to identify and resolve the reasons for late payments on invoices. DFAS recorded its lowest average percentage of overaged invoices on hand — dropping from 8.67 percent during the last six months of FY 2001 to 3.61 percent for the same period in FY 2002. These efforts reduced the amount of interest paid per million dollars spent on contractor and vendor support from about \$343 in FY 2001 to \$237 in FY 2002, a decrease of more than 30 percent.

Best value to our commercial pay customers means paying their contract and vendor invoices accurately and on time to strengthen an ongoing relationship between the Department of Defense and its private sector business partners. It also means safeguarding the fiscal resources of the Department of Defense by preventing incorrect payment and collecting debt when appropriate. Moving forward, DFAS looks to continue to improve payment accuracy and timeliness, expand end-to-end electronic work flow and invoicing and further reduce interest penalty payments.

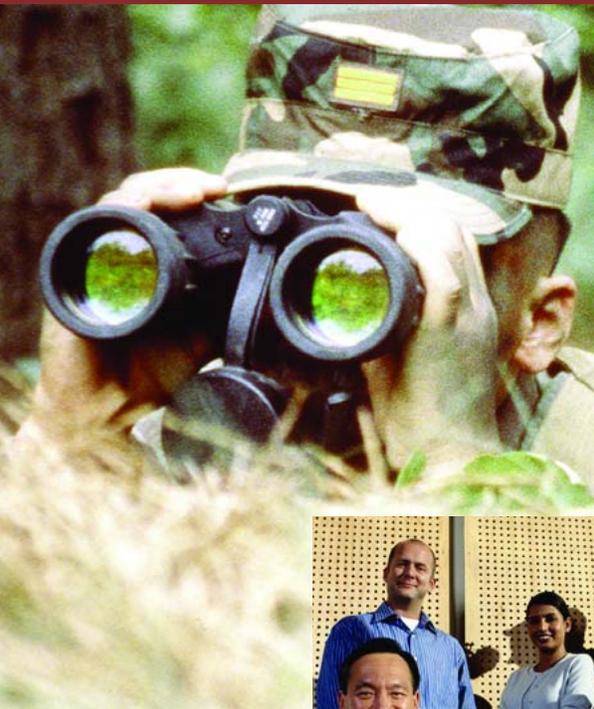
Integrity Innovation Service

“DCAA received an unqualified audit opinion on the FY 2001 financial statements, and is on schedule for a similar unqualified opinion in FY 2002. DFAS’ longstanding professionalism and cooperation has significantly contributed to DCAA’s financial and accounting success, and to the success of the DCAA and DFAS partnership.”

–Jody A. Trenary
Assistant Director, Resources
Defense Contract Audit Agency



Accounting Services



Increasing accounting services value for our customers

The Accounting Services Business Line represents about 44 percent of DFAS business revenue and delivers timely, meaningful business intelligence to meet the management needs of Defense Department leaders.

Customers at the field and departmental levels depend on DFAS for accounting support for all types of funds — appropriated funds, working capital funds and trust fund activities. Accounting professionals maintain accounting systems and develop procedures to implement federal accounting requirements mandated by Congress, the Office of Management and Budget, Treasury and the Department of Defense.

In FY 2002, the Accounting Services Business Line realized significant results from its efforts to become a more strategy-based organization. The Balanced Scorecard helped to improve the delivery of day-to-day products and services and helped team members see how each contributes to the organization's mission. The team achieved a 99.96 percent timely delivery rate for departmental accounting reports while reducing the number of days to produce the reports, reduced problem disbursements by 90 percent from the FY 1998 baseline, and improved the quality of products and services throughout the business line.

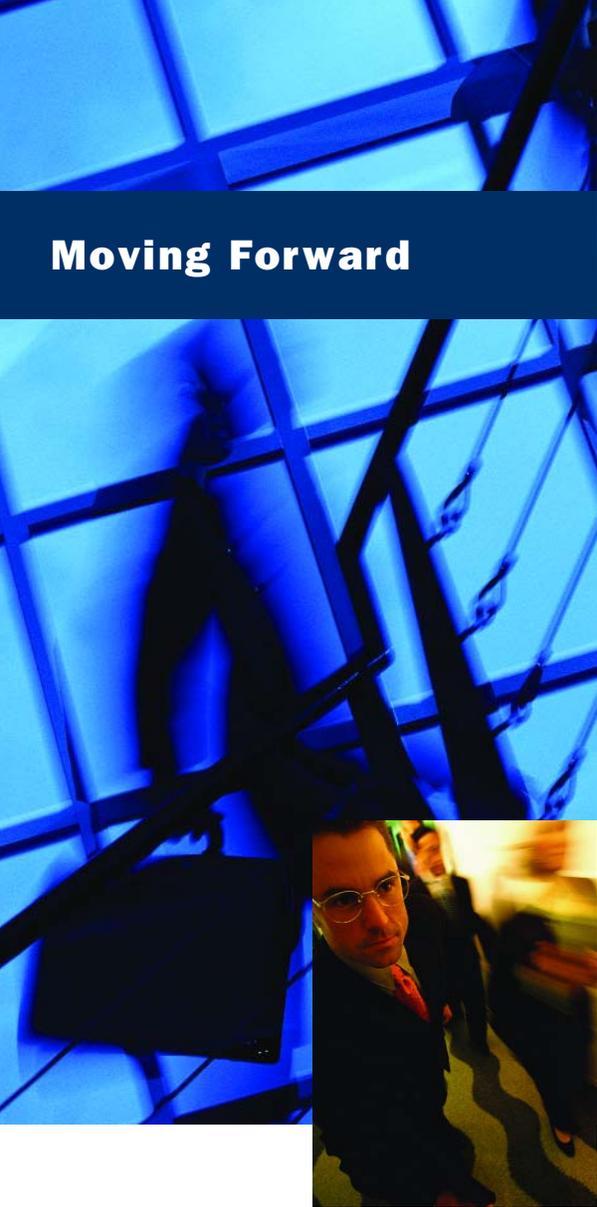
For customers of accounting services, best value means delivering insightful and trusted business intelligence in time to enhance the quality of decisions made by defense leaders. Moving forward, DFAS will refine its day-to-day use of the Balanced Scorecard, pursue opportunities to streamline accounting operations, increase partnering with customers to improve timeliness and accuracy of accounting reports, and deploy new technology and systems aimed at improving products and reducing the cost of doing business.

Integrity Innovation Service

“The DFAS team will conquer challenges of tomorrow by transforming DFAS today. The men and women of America’s Armed Forces, decision-makers throughout our government and our defense-industry partners deserve the very best value in finance and accounting services. DFAS people will not be satisfied with delivering anything less.”

–Thomas R. Bloom
Director
Defense Finance and Accounting Service





Moving Forward

Changing to meet tomorrow's needs today

"Without change, the current defense program will only become more expensive [and] without transformation, the U.S. military will not be prepared to meet emerging challenges," the Quadrennial Defense Review concluded in September 2001.

Our country faces disparate challenges that exert growing pressure to stretch human and fiscal resources. As part of our mission of providing responsive, professional finance and accounting services, DFAS people work aggressively to anticipate finance and accounting needs of the Department of Defense and to ensure DFAS is organized, equipped and prepared to meet those demands.

DFAS is answering this challenge by leaning forward to aggressively pave a clear path toward transformation. Through transformation DFAS intends to improve the services it delivers and to provide those services as economically as feasible. Providing best value to DFAS customers tomorrow means anticipating their needs today.

DFAS leadership understands we must examine all DFAS functions from the bottom up. This comprehensive view will identify what works, what can be improved, and how to continue to make DFAS the best value to the American taxpayers and DFAS customers.

To move out with a smart unified approach, DFAS has developed a transformation strategy to guide this important course of action. This process will take time and begins in FY 2003 with a business case analysis of each product line. Each analysis will generate a set of recommendations on the best way to transform DFAS to best serve our customers.

While DFAS transforms to support tomorrow's defense needs, we continue progress toward becoming a world-class finance and accounting organization. The strategic direction forged in 2001, focused and continued use of the Balanced Scorecard and an ongoing commitment toward managing DFAS operations through meaningful metrics make DFAS progress visible to Defense Department leaders and DFAS customers worldwide.

Delivering the best value to our customers requires continuous vigilance, compassionate service, uncompromising excellence and unquestioned integrity. It also demands DFAS people look to the future while building on the successes of the past. Built on the DFAS core values of integrity, innovation and service, the DFAS team is committed to moving forward. By working together to meet tomorrow's needs, the DFAS team continues to be Your Financial Partner @ Work.

FY 2002 Board of Advisors

The Secretary of Defense established a DFAS Board of Advisors as a forum to build consensus to improve DoD finance and accounting operations.

The Board includes senior military and civilian DoD officials and private sector representatives. They provide advice and recommendations to the Under Secretary of Defense (Comptroller) and Chief Financial Officer and the DFAS Director.

The Honorable Dov S. Zakheim

*Under Secretary of Defense (Comptroller)
and Chief Financial Officer*

General Peter Pace

Vice Chairman, Joint Chiefs of Staff

The Honorable Les Brownlee

Under Secretary of the Army

The Honorable Susan M. Livingstone

Under Secretary of the Navy

The Honorable Peter B. Teets

Under Secretary of the Air Force

General John M. Keane

Vice Chief of Staff, U.S. Army

Admiral William J. Fallon

Vice Chief of Naval Operations, U.S. Navy

General Robert H. Foglesong

Vice Chief of Staff, U.S. Air Force

General Michael J. Williams

Assistant Commandant, U.S. Marine Corps

Thomas R. Bloom

Director, DFAS

Richard Friedland

Consultant

Richard D. Hearney

*formerly President and Chief Executive Officer,
Business Executives for National Security*

Gregory J. Parseghian

*Executive Vice President and
Chief Investment Officer, Freddie Mac*

Josue Robles, Jr.

Senior Vice President and Chief Financial Officer, USAA





DFAS: Here to Serve You

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The DFAS Annual Report is produced by DFAS Corporate Communications.

Additional information and audited financial statements are available on the Web at <http://www.dfas.mil>.

Media queries and requests for additional copies should be directed to DFAS Corporate Communications at 703 607.5072.



Your Financial Partner @ Work

View this report and detailed financial statements online: www.dfas.mil

